

Message Text

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TAGS: EFIN, IT

SUBJECT: PALUMBO REACTIONS TO ECONOMIC SUMMIT AND TO PROSPECTS
FOR ITALIAN'S STABILIZATION PROGRAM

REF: ROME 8814

SUMMARY. AT MEETING ON JULY 7 WITH TREASURY DEPUTY ASSISTANT
SECRETARY WIDMAN, MINTREAS DIRECTOR GENERAL PALUMBO GAVE FAVOR-
ABLE REACTION TO OUTCOME OF ECONOMIC SUMMIT IN PUERTO RICO. HE
THOUGHT THAT ITALIAN DELEGATION HAD BEEN MADE CLEARLY AWARE
THAT ADDITIONAL FOREIGN ECONOMIC ASSISTANCE COULD ONLY BE
EXPECTED WITHIN FRAMEWORK OF STRONG ECONOMIC STABILIZATION
PROGRAM. PALUMBO INDICATED THAT PRELIMINARY STEPS WERE BEING
TAKEN TO FORMULATE STABILIZATION PROGRAM WHICH HE HOPED WOULD
PLAY IMPORTANT ROLE IN FORMATION OF NEW GOVERNMENT. HE
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SUGGESTED THAT PRIOR DEPOSIT REQUIREMENT MIGHT NOT BE REMOVED

COMPLETELY ON SHCHEDULE. END SUMMARY.

1. DR. PALUMBO SAID THAT COMMENTS BY ITALY'S FOREIGN PARTNERS AT PUERTO RICO SUMMIT AND AT RECENT ECONOMIC POLICY COMMITTEE MEETING AT OECD HAD BEEN HELPFUL IN PERSUADING ITALIAN POLICY-LEVEL OFFICIALS THAT NEW FOREIGN FINANCIAL ASSISTANCE WOULD ONLY BE GRANTED WITHIN FRAMEWORK OF ECONOMIC STABILIZATION PROGRAM WHICH INCLUDED POLICIES TO DEAL WITH LARGE BUDGET DEFICIT, EXCESSIVE RISE IN WAGE RATES, AND GROWTH OF MONETARY LIQUIDITY. LATTER MIGHT BE DEALT WITH THROUGH REDUCTION IN INFLATIONARY FINANCING OF BUDGET DEFICIT. ALTHOUGH TREASMIN COLOMBO WAS MEMBER OF OUTGOING GOVERNMENT AND MIGHT NOT HOLD THAT POST IN NEW GOVERNMENT, HE WAS DOING HIS BEST FOLLOWING PUERTO RICO MEETING TO ENCOURAGE FORMULATION OF ECONOMIC STABILIZATION PROGRAM.

2. PALUMBO THOUGHT THAT SOME SUCCESS IN LIMITING SHARP INCREASE IN LABOR COSTS NO LONGER SEEMED AS IMPOSSIBLE AS IT HAD SOME MONTHS EARLIER. IN FACT, IT- MIGHT BE POSSIBLE TO OBTAIN SOME FORM OF CONSENSUS WITH LABOR UNIONS. THIS, HOWEVER, WOULD FALL SHORT OF FORMAL "SOCIAL PACT." ONE QUID PRO QUO FOR COOPERATION OF LABOR UNIONS MIGHT BE ATTACK ON BOTH TAX EVASION AND ON LEGAL TAX AVOIDANCE.

3. AS TO BUDGET DEFICIT PROBLEM, PALUMBO THOUGHT THAT PARLIAMENT WOULD HAVE TO REVIEW SOME OF ITS PREVIOUS APPROPRIATIONS, AND IT WOULD BE NECESSARY FOR GOVERNMENT TO PRESENT PARLIAMENT WITH SPECIFIC CHOICES AS TO WHERE EXPENDITURE CUTS MIGHT BE MADE. (HE SEEMED TO IMPLY THAT CUTS MIGHT HAVE TO BE MADE IN PARTS OF 1975 ANTI-RECESSION EXPENDITURE PACKAGE.) APPROPRIATIONS BUDGET FOR 1977 WAS BEING FINALIZED FOR PRESENTATION TO PARLIAMENT AS REQUIRED BY JULY 31. MINISTER COLOMBO HOPED THAT IT WOULD BE POSSIBLE TO PRESENT CASH BUDGET ESTIMATES ALONG WITH APPROPRIATIONS BUDGET. PALUMBO WAS NOT YET ABLE TO GIVE A BUDGET DEFICIT ESTIMATE FOR 1977, BUT ALLUDED TO DEFICIT FIGURE OF 23,500 BILLION LIRE WHICH HAD ARISEN DURING ELECTION CAMPAIGN (RE REFTEL). ALSO, PALUMBO HAD HEARD OF AN EC COMMISSION STAFF ESTIMATE OF 17,000 BILLION LIRE DEFICIT FIGURE FOR 1977. HE THOUGHT THAT LARGER FIGURE ASSUMED NO POLICY ACTION, WHEREAS EC STAFF

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SEEMED TO BE ASSUMING SOME DELIBERATE SLOWDOWN IN EXPENDITURES. IN ANY CASE, PALUMBO THOUGHT THAT EVERYONE IN ITALY NOW AGREED THAT BUDGET DEFICIT COULD NOT CONTINUE TO GROW IN THIS WAY. BURDEN OF INTEREST PAYMENTS ON PUBLIC DEBT, ALONE, WOULD BECOME INTOLERABLE. HE ALSO THOUGHT THAT LEGAL LIMIT SHOULD BE FIXED ON AMOUNT OF MONETARY FINANCING OF BUDGET DEFICIT. HE WAS HOPEFUL THAT STRONG ACTION TO REDUCE BUDGET DEFICIT WOULD HAVE RATHER IMMEDIATE EFFECT ON RATE OF INFLATION.

4. PALUMBO SAID THAT ECONOMIC EXPERTS OF BANK OF ITALY AND OTHER EXPERTS HAD MADE SOME PRELIMINARY ECONOMIC POLICY SUGGESTIONS TO MINISTER COLOMBO. HE HOPED THAT RECOGNITION OF NEED FOR STRONG ECONOMIC STABILIZATION PROGRAM WOULD PLAY IMPORTANT ROLE IN FORMATION OF NEW GOVERNMENT AND IN FORMULATION OF NEW GOVERNMENT PROGRAM. HOWEVER, HE COULD NOT YET FEEL CERTAIN THAT THIS WOULD BE OUTCOME OF CURRENT COMPLEX POLITICAL NEGOTIATIONS.

5. DR. PALUMBO THOUGHT THAT-IN RECENT MONTHS, BEFORE INTRODUCTION OF PRIOR DEPOSIT, THERE HAD BEEN SOME ANTICIPATORY BUYING OF IMPORTS. HOWEVER, SUBSEQUENTLY BUSINESSMEN HAD PROBABLY BEEN LIVING OFF THESE INVENTORIES TO SOME EXTENT SO THAT IMPORT LEVELS MAY RISE LATER ON. CONSEQUENTLY, GOI WOULD HAVE TO PUSH HARD ON EXPORTS IN 1977. AS TO TERMINATION OF PRIOR DEPOSIT REQUIREMENT, PALUMBO SAID THAT SINCE IT WAS UNLIKELY THAT COMPREHENSIVE STABILIZATION PROGRAM WOULD BE COMPLETED BY THEN, GOI MIGHT NOT COMPLETELY TERMINATE MEASURE AS SCHEDULED ON AUGUST 3. HOWEVER, MEASURE SHOULD NOT BE KEPT IN PLACE BEYOND BRIEF ADDITIONAL PERIOD, SINCE IT NOT ONLY HURT FOREIGN EXPORTERS BUT ALSO RISKED ARRESTING ITALY'S ECONOMIC RECOVERY.

6. PALUMBO RECOGNIZED NEED FOR DEALING WITH THREAT OF RESURGENCE OF INFLATION IN INDUSTRIAL COUNTRIES AS ECONOMIC RECOVERY PROGRESSES. HOWEVER, HE HOPED THAT STRONG "LOCOMOTIVE" ECONOMIES WOULD NOT FOLLOW POLICIES, ESPECIALLY TIGHT MONETARY POLICY, WHICH WOULD IMPEDE FRAGILE RECOVERY IN WEAKER COUNTRIES. STRONG ECONOMIES MIGHT, INSTEAD, RELY MORE HEAVILY ON FISCAL POLICIES THAN ON MONETARY POLICIES. VOLPE

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